

General Information Letter: Compensation paid for past service performed in Illinois is "paid in this State." However, no withholding is required.

April 17, 2002

Dear:

This is in response to your facsimile that Legal Services received on March 18, 2002 in which you state the following:

We have certain former employees that we make Executive compensation payments to after they no longer work for our company. These payments can be made in the year they leave our company as well as in subsequent years. These payments represent bonus payments, incentive compensation, as well as stock dividends and stock option exercises.

Additionally, we have retired employees that receive life insurance coverage in excess of \$50,000.00. These calculations can be for the year they were last employed as well as subsequent years. We report imputed income on the excess according to the group term life calculations.

Does your state require that we report these amounts for a) state withholding purposes and b) for state unemployment purposes?

According to the Department of Revenue ("Department") regulations, the Department may issue only two types of letter rulings: Private Letter Rulings ("PLR") and General Information Letters ("GIL"). The regulations explaining these two types of rulings issued by the Department can be found in 2 Ill.Adm.Code §1200, or on the website <http://www.revenue.state.il.us/legalinformation/regs/part1200>.

Due to the nature of your inquiry and the information presented in your letter, we are required to respond with a GIL. GILs are designed to provide background information on specific topics. GILs, however, are not binding on the Department.

This letter will address your questions relating to Illinois state withholding requirements. The Illinois Department of Revenue does not administer the state unemployment program. For that reason you will need to contact the Illinois Department of Employment Security for your questions concerning unemployment issues. Please send your inquiries to:

Illinois Department of Employment Security
400 West Monroe, Suite 303
Springfield, IL 62704-1823

Regarding the requirements of Illinois withholding on Executive compensation payments, Section 1501(a)(3) of the Illinois Income Tax Act ("IITA"; 35 ILCS 5/101 et seq.) defines the term "compensation" to mean wages, salaries, commissions and any other form of remuneration paid to employees for personal services. The Illinois Administrative Code further describes the statutory definition of compensation in 86 Ill.Adm.Code 100.3100(c):

The name by which remuneration for services is designated is immaterial. Thus, salaries, fees, bonuses, commissions on sales or on insurance premiums, and pensions and retired pay

are compensation within the meaning of the statute if paid for services performed by an employee for his employer.

86 Ill. Adm. Code 100.3100(d) states:

Remuneration for personal services constitutes compensation even though at the time paid the relationship of employer and employee no longer exists between the person in whose employ the services were performed and the individual who performed them, so long as such relationship existed when the services were rendered.

Although your letter does not inquire about payments to nonresidents, Section 302(a) of the IITA states in part:

All items of compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual who is a nonresident at the time of such payment ... shall be allocated to this State.

Pursuant to these provisions, the Executive compensation payments must generally be considered "compensation" for purposes of the IITA, and are taxable in Illinois if "paid in this State" under IITA Section 302(a).

86 Ill. Adm. Code 100.3120(a)(1) states that compensation is paid in Illinois if:

- (A) The individual's service is localized in Illinois because it is performed entirely within Illinois;
- (B) The individual's service is localized in Illinois although it is performed both within and without Illinois, because the service performed without Illinois is incidental to the individual's service performed within Illinois; or
- (C) The individual's service is not localized in any state but some of the service is performed within Illinois and either (i) the base of operations, or if there is no base of operations, the place from which the service is directed or controlled is within Illinois, or (ii) the base of operations or the place from which the service is directed or controlled is not in any state in which some part of the service is performed, but the individual's residence is in Illinois.

86 Ill. Adm. Code 100.3120(b) specifically provides that compensation paid for past service shall be considered paid in Illinois:

Where compensation is paid to a nonresident for past service, such compensation will, for the purpose of determining whether and to what extent such compensation is "paid in" Illinois and is allocated to Illinois under IITA Section 302(a), be presumed to have been earned ratably over the employee's last 5 years of service with the employer ..., in the absence of clear and convincing evidence that such compensation is properly attributable to a different period of employment ... Compensation earned in each past year will be deemed compensation paid in Illinois if the individual's service in such year met the tests set forth in [100.3120(a)].

If the information provided above leads you to believe that your employees are receiving "compensation paid in this State", Section 701(a) of the IITA would require you to withhold Illinois income taxes:

- (a) In General. Every employer maintaining an office or transacting business within this State and required under the provisions of the Internal Revenue Code to withhold a tax on:
 - (1) compensation paid in this State (as determined under Section 304(a)(2)(B)) to an individual[.]

For your convenience, enclosed please find Booklet IL-700 entitled "Illinois Withholding Tax Guide" and Booklet IL-700-T entitled "Illinois Withholding Tax Tables".

As stated above, this is a general information letter which does not constitute a statement of policy that either applies, interprets or prescribes tax law. It is not binding on the Department. Should you have additional questions, please do not hesitate to contact our office.

Sincerely,

Heidi Scott
Staff Attorney -- Income Tax